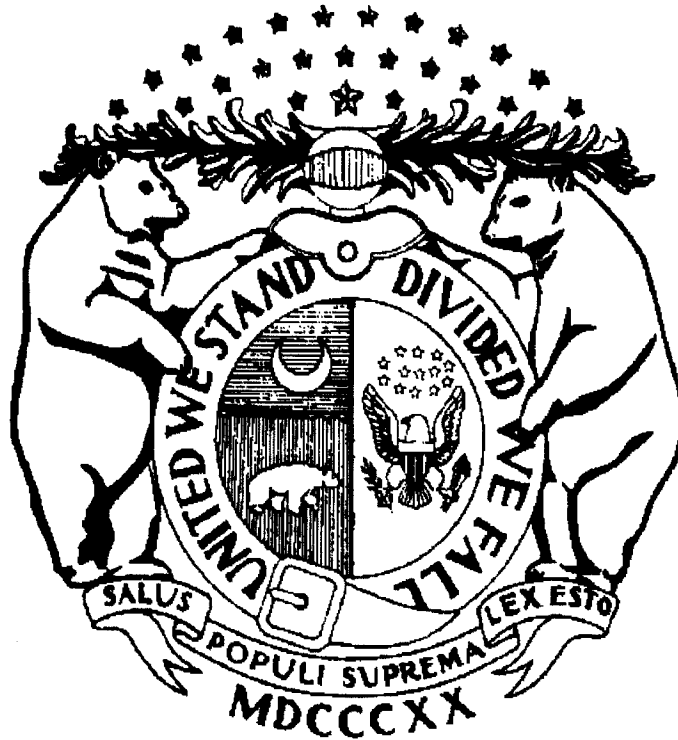


**REPORT OF THE  
ASSOCIATION FINANCIAL EXAMINATION OF  
WESTPORT INSURANCE CORPORATION**

**AS OF  
DECEMBER 31, 2003**



**STATE OF MISSOURI  
DEPARTMENT OF INSURANCE  
JEFFERSON CITY, MISSOURI**

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Overland Park, Kansas  
February 8, 2006

Honorable Alfred W. Gross, Commissioner  
Virginia Bureau of Insurance  
Chairman, Financial Condition (E) Committee

Honorable Jorge Gomez, Commissioner  
Wisconsin Department of Insurance  
Secretary, Midwestern Zone, NAIC

Honorable Linda S. Hall, Director  
Alaska Division of Insurance  
Secretary, Western Zone, NAIC

Honorable W. Dale Finke, Director  
Missouri Department of Insurance  
301 West High Street, Room 530  
Jefferson City, Missouri 65101

Ladies and Gentlemen:

In accordance with your financial examination warrant, a full scope association financial examination has been made of the records, affairs and financial condition of

**Westport Insurance Corporation**

hereinafter referred to as such, as Westport, WIC, or as the Company. Its administrative office is located at 5200 Metcalf Avenue, Overland Park, Kansas 66202, telephone number (913) 676-5200. This examination began on August 30, 2004, and concluded on the above date.

## **SCOPE OF EXAMINATION**

### **Period Covered**

The prior full scope association financial examination of Westport was made as of December 31, 2000, and was conducted by examiners from the State of Missouri representing the Midwestern Zone of the National Association of Insurance Commissioners (NAIC), with the Southeastern and Northeastern zones also participating.

The current full scope association financial examination covered the period from January 1, 2001, through December 31, 2003, and was conducted by examiners from the States of Missouri and Nevada, representing the Midwestern and Western Zones of the NAIC, respectively. This examination was performed concurrently with examinations of the Company's parent, Employers Reinsurance Corporation (ERC), and an affiliate, First Specialty Insurance Corporation (First Specialty or FSIC). The examination was updated to review the loss reserves recorded as of December 31, 2004.

This examination also included the material transactions and/or events occurring subsequent to the examination date, which are noted in this report.

### **Procedures**

This examination was conducted using the guidelines set forth in the Financial Condition Examiners Handbook of the NAIC, except where practices, procedures and applicable regulations of the Missouri Department of Insurance (MDI) and statutes of the State of Missouri prevailed.

The examiners relied upon information supplied by the Company's independent auditor, KPMG, LLP, of Kansas City, Missouri, for its audit covering the period from January 1, 2003, through December 31, 2003. Information relied upon included confirmations, account reconciliations, and narrative descriptions of processes and controls.

### **Comments - Previous Examination**

The previous financial examination of WIC was conducted by the MDI for the period ending December 31, 2000. Listed below are the comments, recommendations, and notes from the previous examination report, the Company's response, and the findings in the current examination.

### **Conflicts of Interest**

*Comment:* It was noted that several officers and directors did not complete conflict of interest statements during 2000 and 2001. It was recommended that all officers and directors execute a conflict of interest statement annually.

*Company's Response:* The Company stated that it has implemented an online form for completion, created a repository of conflict of interest statements, and will ensure that all officers and directors execute such statements annually.

*Current Findings:* Several officers and directors did not complete conflict of interest statements during the examination period. However, the Company has implemented new controls and as a result, it was noted that all officers and directors completed conflict of interest statements in 2004.

### **Intercompany Agreements**

*Comment:* The Company was directed to terminate any and all intercompany agreements that are no longer being utilized.

*Company's Response:* The Company stated that it would terminate any agreements no longer being utilized.

*Current Findings:* Several agreements were identified that had no transactions involving First Specialty during the examination period. Refer to the Intercompany Transactions section of this report for a complete explanation.

### **Intercompany Agreements**

*Comment:* For any agreements involving several entities, the Company was directed to ensure that costs are properly allocated to the other entities in accordance with the provisions of each agreement.

*Company's Response:* The Company stated it had previously explained its cost allocation formulas to the MDI and such costs are allocated through an accounting system designed to ensure that proper allocation occurs. The Company also stated it would ensure that costs are properly reported.

*Current Findings:* No problems were noted with the cost allocations for intercompany agreements.

### **Intercompany Agreements**

*Comment:* For agreements with GE Capital International Services, Inc. (GECIS), Electronic Data Management International (EDMI), and the related Statements of Work (SOWs), the Company was directed to ensure that accounting for costs is completed and reported in such a manner that payments due or made for each SOW can be individually identified and reported as required by the agreements and MDI's approval thereof.

*Company's Response:* The Company stated that it had implemented an accounting process for tracking and individually identifying payments for SOWs, and has provided the MDI with payment and savings information as requested or where non-disapproval of such agreements has been otherwise conditioned.

*Current Findings:* The Company provided workpapers that listed the amount of payments made by Westport for each of the SOWs with GECIS and EDM I.

### **Intercompany Agreements**

*Comment:* The Company was directed to ensure accurate reporting and disclosure of all intercompany transactions in the various schedules and exhibits of the Annual Statement, including Schedule Y and the Notes to the Financial Statements.

*Company's Response:* The Company stated that it would ensure that intercompany transactions are accurately reported and disclosed in the Annual Statement.

*Current Findings:* The Company could not provide a reconciliation to identify the amounts paid or received by Westport for each intercompany agreement that would support the payments with affiliates that were reported in Schedule Y – Part 2 of the 2003 Annual Statement. A further description is included in the Intercompany Transactions section of this report.

### **Intercompany Agreements**

*Comment:* It was noted that there were instances where intercompany transaction exist without the underlying agreement and required filing and notification of the MDI. Examples were the payroll services provided by Corporate Payroll Relations (CPARS), the pension services, post-employment pension services, and administration services provided by General Electric Company on behalf of Westport, and the assignment and re-assignment between ERC and Westport with respect to an ownership interest in IRI. For each of these relationships and other transactions, the Company was directed to draw up the underlying agreement governing the transactions in accordance with the applicable Missouri insurance holding company law.

*Company's Response:* The Company stated that it had drafted agreements for the above transactions and the agreements had been approved by the MDI. The Company also stated that when transactions without underlying agreements are identified, Westport will draft underlying agreements and submit them to MDI for approval as Form D filings.

*Current Findings:* WIC and other affiliates executed a Service Reimbursement Agreement, effective April 8, 2004, with GE for the payroll, pension, and employee benefits services provided by GE. An Assignment Agreement between ERC and Westport, which assigns Westport's ownership interest in IRI to ERC, was executed in August 10, 2004, with a retroactive effective date of January 1, 2001. Refer to the Intercompany Agreements section of this report for further information on these agreements.

### **Intercompany Agreements**

*Comment:* It was noted that there were many instances where material intercompany transactions were first implemented by the Company prior to notifying the MDI in violation of the applicable Missouri insurance holding company law. The Company was directed to desist from this practice.

*Company's Response:* The Company stated that it had educated and continues to educate its staff about the requirements of the Missouri holding company law and submits such transactions through Form D filings where required by Missouri law.

*Current Findings:* Intercompany agreements that were entered into during the current examination period were found to have been submitted to the MDI for prior approval, as required.

### **Reporting of Industrial Risk Insurers (IRI) Business**

*Comment:* It was noted that Westport incorrectly reported IRI business as being ceded to ERC on Schedule F – Part 3 of the 2000 Annual Statement. It was recommended that the IRI business be reported as ceded to IRI on Schedule F – Part 3 in the future.

*Company's Response:* The Company stated that it followed the recommendation of the MDI for its 2003 Annual Statement.

*Current Findings:* The Company reported IRI business as ceded to IRI on Schedule F – Part 3 of the 2003 Annual Statement, in compliance with the recommendation from the prior examination report. Refer to the Reinsurance Ceded section of this report for details of premiums and loss reserves that were reported as ceded to IRI.



### **Insolvency Clauses in Reinsurance Agreements**

*Comment:* The Company was directed to update all of its existing reinsurance agreements so that the insolvency clause in each agreement is in compliance with Missouri Regulation 20 CSR 200-2.100(11)(A), Credit for Reinsurance. The Company was also directed to ensure that future reinsurance agreements comply with this regulation.

*Company's Response:* The Company stated that it continues to work with the MDI on acceptable language for insolvency clauses to be included in WIC's reinsurance agreements.

*Current Findings:* As of the date of this report, the MDI and WIC are continuing to work towards an agreement on acceptable language to be included in the insolvency clause.

### **Reporting Date for Annual Statement Information**

*Comment:* It was noted that the Company's 2000 Annual Statement was based upon a year-end reporting date other than December 31. It was also noted the Company had proposed a year-end reporting date of approximately one week prior the last business day prior to December 31 in order to facilitate reporting requirements of the ultimate parent company. It was recommended that the Company consistently apply this plan for a year-end cut-off date in the future.

*Company's Response:* The Company stated that it has consulted with MDI concerning this issue and will ensure consistent application of its year-end cut-off date plan.

*Current Findings:* Although there were some inconsistencies, in general, the Company closed its 2003 financial statements, as of December 18, 2003. Refer to the Accounts and Records section for further information.

### **Coordination for Examination Requests**

*Comment:* It was noted that the Company was unable to comply with Missouri Regulation 20 CSR 200-4.010(4) (Time and Limits) which states that an insurer shall provide, within five (5) working days, any records requested by financial examiners during an on-site financial examination. The following recommendations were directed to enable the Company to comply with this regulation: (1) implement procedures that will facilitate on-site examination in the future, (2) appoint a senior management person to serve as a general coordinator to facilitate the examination process, (3) add resources that will enable the Company to generate, maintain and retrieve supporting documentation upon request in a timely manner.

*Company's Response:* The Company stated it has conducted staff education designed to facilitate future on-site examinations, and will conduct additional training in anticipation of the next on-site examination. The Company stated that it will appoint a senior management person to serve as a general coordinator and will designate certain individuals to act as day-to-day

contact persons for particular aspects of future examinations. The Company also stated it has added resources to ensure that information can be made available in a timely manner.

*Current Findings:* There were some lengthy delays to receive some of the information requested during the examination. However, the overall coordination and facilitation of the examination process was improved from the prior examination and was acceptable, considering the size and complexity of the Company.

## **Information Systems**

*Comment:* It was noted that the review of WIC's information systems and related environment was significantly hindered by the limited or minimal cooperation exhibited by the staff responsible for this function. The Company was directed to ensure that information systems personnel provide necessary cooperation and documentation in a timely manner.

*Company's Response:* The Company stated that it would work with the parent company, ERC, to ensure compliance with the MDI's directive. The Company stated that ERC will advise its information systems personnel of such requirements and ensure that such cooperation occurs during the next financial examination.

*Current Findings:* No problems were noted in obtaining documentation or cooperation from the information systems personnel.

## **HISTORY**

### **General**

The Company operates as a stock property and casualty insurer in Missouri under the insurance laws of Chapter 379 RSMo (Insurance Other Than Life). A brief corporate history of the Company is summarized below.

- The Company was originally incorporated as The Manhattan Fire and Marine Insurance Company under the laws of the State of New York and began business on January 5, 1924.
- The Company's name was changed to Puritan Insurance Company on October 1, 1976.
- The Company redomesticated from New York to Connecticut on December 31, 1977.
- The Company redomesticated from Connecticut to Missouri, effective April 22, 1992.
- On October 1, 1992, all outstanding capital stock of the Company was purchased by ERC from General Electric Capital Corporation, an affiliate, for \$50,000,000. The Company was subsequently renamed Westport Insurance Corporation.
- Effective June 30, 1998, Puritan Excess and Surplus Lines Insurance Company, an affiliate, was merged into the Company. WIC paid an extraordinary dividend of \$195,000,000 to ERC as consideration for the merger.

**Capital Stock**

The Company's Articles of Incorporation, effective December 31, 2003, allowed for the issuance of 250,000 shares of common stock with a par value of \$20 per share. As of December 31, 2003, all 250,000 shares of common stock were issued and outstanding for a total common capital stock balance of \$5,000,000. ERC owns 100% of WIC's issued and outstanding common stock.

**Dividends**

No dividends or cash distributions were paid or declared during the examination period.

**Management**

The management of the Company is vested in a Board of Directors that are appointed by the shareholders. The Articles of Incorporation specify that the number of directors shall not be less than nine (9) and not more than twenty-five (25). All directors at the end of 2003 were employees of the parent, ERC. The Board of Directors appointed and serving, as of December 31, 2003, were as follows:

<u>Name</u>	<u>Address</u>	<u>Position Held with ERC</u>
Ronald R. Pressman	New Canaan, Connecticut	Chairman of the Board, President and Chief Executive Officer
John W. Attey	Shawnee, Kansas	Senior Vice President - Claims, Secretary
Samira Barakat	Kansas City, Missouri	Senior Vice President - Risk Management
Jeanne K. Mason	Overland Park, Kansas	Senior Vice President - Human Resources
Marc A. Meiches	Leawood, Kansas	Executive Vice President and Chief Financial Officer
John C. Narvell	London, England	Senior Vice President and Chief Actuary
A. Louis Parker #	Overland Park, Kansas	Exec. Vice President - Commercial Insurance
Richard F. Smith	Minnetonka, Minnesota	Executive Vice President - P&C Reinsurance
Alfred J.V. Stanley #	Leawood, Kansas	Executive Vice President - Global Life & Health
William J. Steilen	Overland Park, Kansas	Senior Vice President – Global Treasury

# A. Louis Parker and Alfred J.V. Stanley resigned effective June 17, 2004  
Mark E.M. Elborne was elected as a director effective March 1, 2004

**Committees**

The committees of the Board of Directors consist of an Executive Committee and an Investment Committee. These committees operate in accordance with the Company's Bylaws. The members of the committees as of December 31, 2003, were as follows:

<u>Executive Committee</u>	<u>Investment Committee</u>	
Ronald R. Pressman	Ronald R. Pressman	Richard F. Smith
Marc A. Meiches	Marc A. Meiches	Alfred J.V. Stanley
Richard F. Smith	Thomas A. Powers	Stephen DeVos
A. Louis Parker	Kieran Dempsey	Kathryn Karlic
	A. Louis Parker	Samira Barakat

**Officers**

The Board of Directors elect many Vice Presidents and Assistant Vice Presidents, which are too numerous to list in this report. The senior executive officers elected by the Board of Directors and serving as of December 31, 2003, were as follows:

Ronald R. Pressman	Chairman and Chief Executive Officer
A. Louis Parker <sup>#</sup>	President and Chief Operating Officer
John F. Frye	Senior Vice President and Chief Financial Officer
William E. Donnell <sup>*</sup>	Senior Vice President
Michael J. Gill	Senior Vice President
David G. Newkirk	Vice President, General Counsel, and Secretary
Kenneth J. Holferty	Treasurer

<sup>#</sup> Effective June 17, 2004, A. Louis Parker resigned and was replaced by Richard F. Smith as President and Chief Operating Officer.

<sup>\*</sup> William E. Donnell's term expired December 31, 2004 and was not reelected.

Robin P. Sterneck was elected Senior Vice President, effective January 1, 2005.

**Conflict of Interest**

The Company has a policy that requires all officers, directors, and key employees to complete a conflict of interest statement each year. Signed statements of officers and directors were reviewed for the examination period. No significant exceptions were noted.

**Corporate Records**

A review was made of the Articles of Incorporation and Bylaws for the examination period. The Articles of Incorporation were not amended during the examination period. The Bylaws were amended on July 10, 2001 to change the required frequency of the Board of Directors' meetings from a quarterly basis to one annual meeting with the option for other meetings upon a Board resolution.

The minutes of the Board of Directors' meetings, committee meetings, and stockholders' meetings were reviewed for proper approval of corporate transactions. In general, the minutes appear to properly reflect and approve the Company's major transactions and events for the period under examination.

**Acquisitions, Mergers and Major Corporate Events**

None.

**Surplus Debentures**

No surplus debentures were issued or outstanding for the period under examination.

**AFFILIATED COMPANIES**

**Holding Company, Subsidiaries and Affiliates**

The Company is a member of an Insurance Holding Company System as defined by Section 382.010, RSMo (Definitions). An Insurance Holding Company System Registration Statement was filed by the Company's parent, ERC, on behalf of itself, WIC, and ERC's other insurance subsidiaries, for each year of the examination period. The Company does not have any subsidiaries.

WIC is directly owned 100% by ERC. ERC is one of the largest property and casualty reinsurers in the world. ERC's non-affiliated assumed business is mostly from casualty lines such as worker's compensation, disability, and other liability lines. Significant business is also assumed from ERC's European and U.S. subsidiaries, including WIC, and other affiliates. Below is description of the material subsidiaries of ERC.

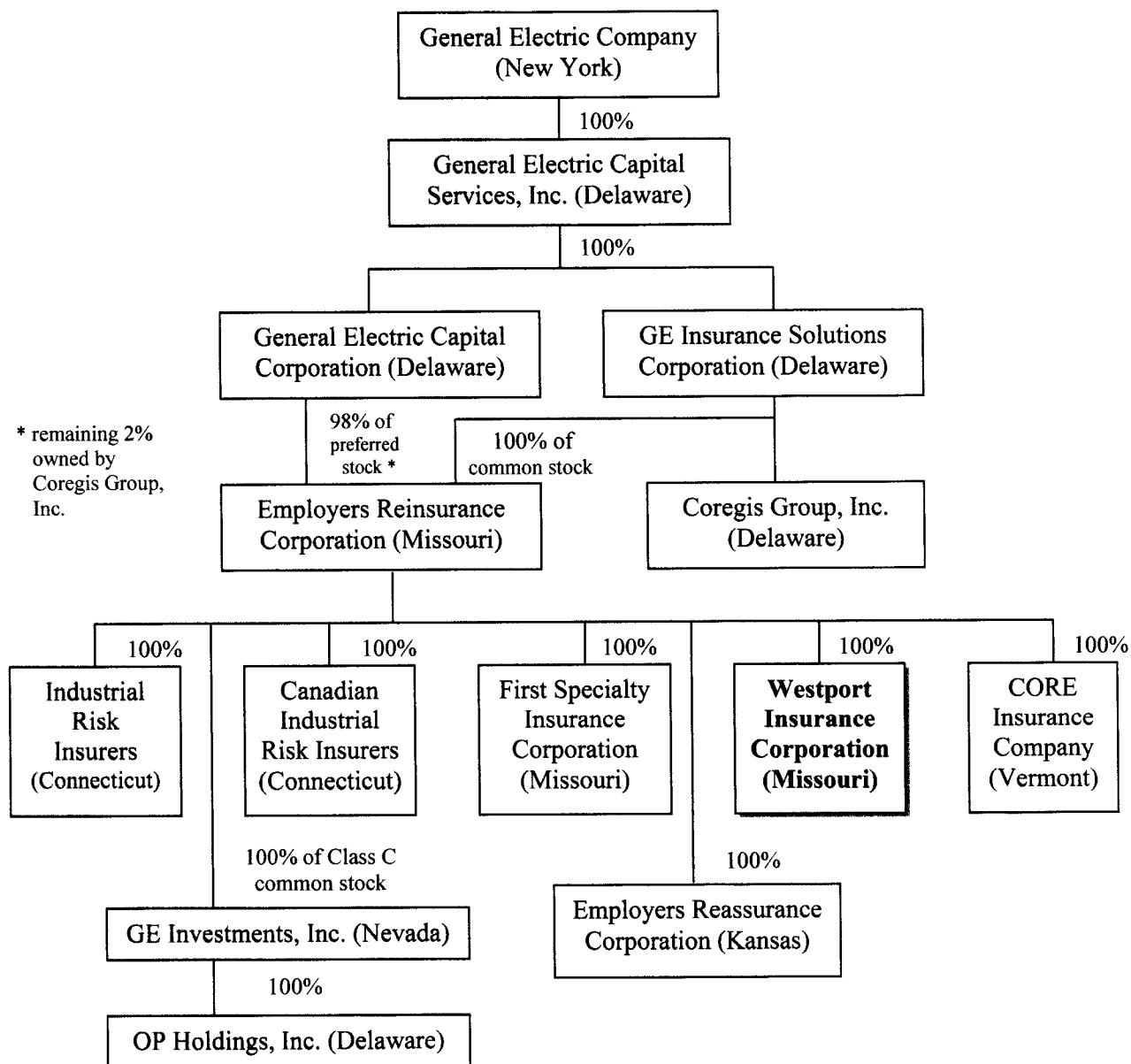
- Employers Reassurance Corporation (ERAC) is a life and health reinsurer.
- OP Holdings, Inc. is the holding company for over twenty insurance, reinsurance, and holding companies located mostly in Europe, including the United Kingdom, Ireland, Denmark, France, Germany, and Luxembourg. ERC owns OP Holdings through its 100% ownership of the Class C common stock of GE Investments, Inc.
- First Specialty Insurance Corporation (FSIC) is an excess and surplus lines insurer that specializes in commercial lines of wind and earthquake coverage, general liability, property, hospital professional liability, and lawyer's professional liability.
- Industrial Risk Insurers (IRI) is an voluntary joint underwriting association in which ERC has a 99.5% direct membership interest. WIC has the remaining 0.5% direct membership interest, but has an agreement that assigns that interest to ERC. IRI writes large property risks usually involving multiple locations.
- Canadian Industrial Risk Insurers (Canadian IRI) is also a voluntary joint underwriting association in which ERC has a 100% membership interest. Canadian IRI writes the same types of policies as IRI, but in Canada only.
- Core Insurance Company is a property and casualty reinsurer, but does not have any active operations. All of its reinsurance agreements were novated to ERC, effective December 31, 2003.

ERC is directly controlled by GE Insurance Solutions Corporation, which owns 100% of ERC's common stock. GE Insurance Solutions is a holding company that owns several other insurance and reinsurance companies.

The ultimate controlling entity of WIC is General Electric Company (GE), which is one of the largest organizations in the world. GE is a publicly traded stock company. GE consists of eleven operating segments, including GE Insurance Solutions. The other segments of GE are engaged in providing services or manufacturing in the following industries: commercial and consumer finance, aircraft engines and locomotives, energy industry technologies, consumer appliances, industrial lighting and electrical products, media and entertainment, plastics and advanced materials, power plant products, and medical technologies.

**Organizational Chart**

The following organizational chart depicts the ownership of WIC and the significant subsidiaries owned by the parent, ERC, as of December 31, 2003.



**Intercompany Agreements**

The Company's intercompany agreements in effect, as of December 31, 2003 and subsequent periods, are outlined below.

- 1. Type:** Service Agreement

**Affiliates:** ERC, Employers Reassurance Corporation, GE Insurance Solutions Agency, LLC

**Effective:** February 27, 1986

**Terms:** ERC will provide office space, furniture and equipment and will provide the following services: data processing, accounting, financial, actuarial, legal, executive, personnel, payroll, sales, underwriting, claims and related services necessary to conduct the businesses of the named subsidiaries. Amendment No. 4, dated June 27, 1996, includes an exhibit that shows the calculation of allocated expenses for each affiliate. Allocation percentages are developed from methodologies, such as number of employees and amount of assets, to allocate the various types of expenses.
- 2. Type:** Underwriting Management Agreement

**Affiliate:** CORE Managers, Inc. and FSIC

**Effective:** June 1, 1996

**Terms:** CORE Managers, Inc. agrees to provide underwriting services to write various casualty lines of business for WIC and FSIC. CORE Managers, Inc. has the authority to solicit business, bind and write insurance contracts, determine premiums and brokerage commissions, and collect and account for premiums. Authorized lines of business include automobile liability, general liability, umbrella liability, workers' compensation, employers' liability, self-insured risks, captives, and risk retention groups. The maximum limits for policies written are \$5,000,000 per occurrence, except for workers compensation policies, which is \$10,000,000 per occurrence. WIC and FSIC will pay CORE Managers, Inc. a monthly underwriting management fee that will be determined by mutual agreement among the parties.
- 3. Type:** Guarantee

**Affiliate:** ERC

**Effective:** August 27, 1996

**Terms:** Upon default by WIC, ERC guarantees to make payments due under any contract of insurance or reinsurance issued by the WIC.



**4. Type:** Master Outsourcing Agreement

**Affiliates:** GE Insurance Solutions Corporation, GECIS, FSIC, ERC, ERAC, GE Insurance Solutions Agency, LLC (GEISA), Industrial Risk Insurers (IRI), The Medical Protective Company (Med Pro), GE Re, Coregis Insurance Company, California Insurance Company, Coregis Indemnity Company

**Effective:** March 1, 1999

**Terms:** GECIS will provide the following business outsourcing services for the affiliates: data processing, administrative, actuarial, general accounting, treasury, financial reporting, technical accounting, filing approval notices, agents licensing, claims, underwriting, and other support services. GECIS shall prepare reports relating to performance of the services as reasonably requested. This agreement will be supplemented for each service to be provided by a specific Statement of Work (SOW) to establish in writing the scope of the services, performance standards, pricing and customer provided support for each project. The fees for the services provided shall be agreed to by the parties and incorporated within the individual SOWs.

A summary of the SOWs attached to this agreement in which WIC is a named party is listed in the table below.

SOW No.	Effective Date	Services Provided by GECIS
1	July 1, 2000	Processes for reporting to the Insurance Services Office and state motor vehicle departments
2	May 1, 2000	Claims and underwriting support services
3	May 1, 2000	Cash allocation processes for receipts and disbursements
3a	May 1, 2000	Prepare 1099 forms to be sent to the Internal Revenue Service, payees, and states
3b	May 1, 2000	Prepare general ledger and bank reconciliations
3c	May 1, 2000	Prepare and file escheatment reports with various states
5	April 1, 2000	Profitability and financial analysis
7	November 30, 2000	Data entry for filings with rate service organizations
9	December 1, 2000	Premium tax calculations and prepare accruals
10	September 1, 2000	Record client reported data on the operating system
11	December 1, 2000	Perform reconciliations for statutory reporting
12	March 1, 2001	Actuarial analysis and support processes
16	September 1, 2001	Reinsurance transaction processing and reporting
17	October 26, 2001	General ledger account reconciliations
18	October 26, 2001	Accounting for receipts, disbursements, cash balancing
19	October 1, 2001	Claims and underwriting support services
21	June 1, 2000	Catastrophe exposure analysis and modeling
22	October 31, 2001	Agent receivable reconciliations and collections
32	February 20, 2002	Research, analysis, modeling for risk factors in the business operations
35	November 22, 2002	Pricing modeling, business portfolio analysis
41	January 23, 2004	Pricing, underwriting, binding, and issuance of policies
42	October 12, 2004	Implement a common financial reporting platform

43	September 12, 2004	Scheduling services, customer service center monitoring
44	September 21, 2004	Contract administration, corporate and regulatory support

**5. Type:** Service Mark Agreement**Affiliate:** GE Insurance Solutions Corporation**Effective:** January 1, 2000

**Terms:** GE Insurance Solutions has the right from GE to license the use of the GE logo and other licensed marks. GE Insurance Solutions grants a license to ERC to use the GE logo and other licensed marks. WIC will pay an annual royalty of 0.125% of its total assets, as stated in its GAAP financial statements.

**Exception:** This Agreement was never filed for prior approval with the MDI, as required by Section 382.195 RSMo. (Transactions Within a Holding Company System). The Company is directed to immediately submit this Agreement as part of a Form D filing to the MDI for approval. Payments made by WIC under this Agreement should cease until the Agreement is approved by the MDI.

**6. Type:** Service Agreement**Affiliate:** FSIC**Effective:** October 1, 2000

**Terms:** WIC will provide equipment and will provide the following services: data processing, computer services, accounting, financial, actuarial, legal, executive, personnel, payroll, sales, underwriting, claims and related services necessary to conduct the business of FSIC. FSIC will pay WIC a monthly service fee equal to WIC's monthly operating expenses incurred in rendering the services. WIC is also authorized to collect funds on behalf of FSIC and deposit the money in a FSIC bank account.

**7. Type:** Service Agreement**Affiliate:** GE Insurance Solutions Agency, LLC (GEISA)**Effective:** October 1, 2000

**Terms:** WIC will provide equipment and will provide the following services: data processing, computer services, accounting, financial, actuarial, legal, executive, personnel, payroll, sales, underwriting, claims and related services necessary to conduct the business of GEISA. GEISA will pay WIC a monthly service fee equal to WIC's monthly operating expenses incurred in rendering the services. WIC is also authorized to collect funds on behalf of GEISA and deposit the money in a GEISA bank account.

**8. Type:** Computer Services Agreement

**Affiliates:** General Electric Company, ERC, FSIC, ERAC

**Effective:** November 4, 2000

**Terms:** General Electric Company, acting through its Global Computer Operation Division (GCO), will provide the following computer services: operations, production control, technical services, database administration, data center / network disaster recovery, service level performance, and logical access control. Fees to be paid to GCO by WIC and the other affiliates are based upon scheduled amounts listed in the agreement.

**9. Type:** Federal Tax Allocation Agreement

**Affiliates:** GE Insurance Solutions Corporation, WIC, FSIC, IRI Management Services, LLC, IRI Corporation, IRI Holdings

**Effective:** January 1, 2001

**Terms:** ERC and all other entities in the agreement are included in the consolidated tax return filed by General Electric Company. The federal tax liability of each affiliate shall be calculated on a separate return basis. The subsidiaries of ERC will remit tax payments to ERC. ERC then remits tax payments on behalf of itself and its subsidiaries to GE Insurance Solutions.

**10. Type:** Investment Management and Services Agreement

**Affiliates:** GE Asset Management Incorporated (GEAM), ERC, FSIC

**Effective:** May 1, 2002

**Terms:** GEAM will provide investment management services. The services will include research and identify investment opportunities, assist in developing an overall investment strategy, invest and sell assets in accordance with applicable laws and the investment guidelines of each entity, prepare quarterly reports of the purchases and sales of investments and present such reports to the Board of Directors or Investment Committee, and other services. ERC, WIC, and FSIC will pay GEAM a quarterly management fee equal to 0.053% of the value of the assets managed by GEAM.

**11. Type:** Service Agreement

**Affiliates:** Coregis Insurance Company (Coregis)

**Effective:** June 1, 2002 to May 31, 2007

**Terms:** WIC will provide various support services for the workers compensation policies written by Coregis and 100% reinsured by WIC. The following services will be provided by WIC: data processing, computer services, accounting, actuarial, financial supervision, compliance, human resource, legal, policy pricing review, policy issuance systems and support, risk management, underwriting, claims and reinsurance related services necessary to conduct the business reinsured by WIC. Coregis will reimburse WIC for its actual expenses incurred in rendering the services.

**12. Type:** Services Agreement

**Affiliates:** ERC, GE Reinsurance Corporation

**Effective:** September 16, 2002

**Terms:** ERC will provide equipment and will provide the following services: data processing, accounting, financial, actuarial, executive, personnel, sales, underwriting, claims and related services necessary to conduct the business of GE Re. GE Re will reimburse ERC for its actual and/or budgeted expenses incurred in providing the services based upon a proportionate percentage of annual overhead, salary and expenses. GE Re will also provide the same services (excluding executive) for ERC and WIC and will be reimbursed using the same methodology in which GE Re reimburses ERC.

**13. Type:** Consulting Agreement

**Affiliates:** iProcess International, LLC (iProcess), ERC, FSIC, ERAC, The Medical Protective Company, GE Re, Coregis Insurance Company

**Effective:** December 26, 2002

**Terms:** iProcess will provide the following consulting services: recommendations for improving and standardizing processes, resolving issues outside of standard operating procedures, forecasting operational needs, formulating and implementing outsourcing programs, obtaining outsourcing services, training personnel, and other services. ERC will reimburse iProcess for all of its reasonable costs incurred, including salaries and travel and living expenses, in providing the services for all of the affiliates. WIC will reimburse ERC for its applicable portion of the total costs paid by ERC.

**14. Type:** Service Reimbursement Agreement

**Affiliates:** General Electric Company, ERC, FSIC, GE Re

**Effective:** April 8, 2004

**Terms:** The Global Business Services (GBS) division of GE will provide the following services: payroll, employee benefits, travel and living, and other services. ERC employees will participate in the GE Pension Plan and other GE benefit plans pursuant to this agreement. ERC will pay GBS for the direct costs attributable to its employees and an allocated amount for costs that are not directly attributable. ERC's allocated share is based upon the total annual compensation of ERC employees compared to the total for all GE employees. WIC, FSIC, and GE Re will reimburse ERC for each entity's respective actual or proportional share of the total costs paid by ERC.

**15. Type:** Guarantee

**Affiliate:** GE Insurance Solutions Corporation

**Effective:** December 30, 2004

**Terms:** GE Insurance Solutions agrees to pay WIC any amounts due from unauthorized reinsurers, as identified on Schedule F – Part 5 of the Annual Statement, in the event that the unauthorized reinsurers default on their obligations to WIC. The Guarantee is to be secured by a letter of credit naming WIC as the beneficiary.

In addition to the above listed agreements, Westport has reinsurance agreements with ERC and other affiliates, which are described in the Reinsurance section of this report.

The Company could not provide signed agreements for the Consulting Agreement with iProcess and other affiliates, and the Services Agreement with ERC and GE Re. Therefore, these agreements were apparently never formally executed since they were not signed by the parties. The Company is directed to immediately execute these agreements and cease all transactions until the agreements are executed.

**Intercompany Transactions**

The following table summarizes the payments made during the exam period, between WIC and its affiliates, pursuant to intercompany agreements.

Related Party	Agreement	Net Amount Paid / (Received) by WIC		
		2001	2002	2003
ERC	Service	15,087,201	12,002,373	13,485,331
CORE Managers	Underwriting Management	0	0	0
GECIS	Various SOWs	300,901	1,007,656	2,595,905
GE Insur. Solutions	Service Mark	1,231,125	1,444,787	1,834,740
FSIC	Service	0	0	0
GEISA	Service	0	0	0
GE	Computer Services	0	0	0
ERC	Federal Tax Allocation	3,565,999	(33,321,961)	(28,720,712)
GEAM	Investment Management	0	154,243	603,645
Coregis	Service	0	0	0
GE Re	Services	0	0	0
iProcess	Consulting	0	0	0
GE	Service Reimbursement	19,962,733	19,831,047	20,610,834
<b>TOTAL</b>		<b>\$40,147,959</b>	<b>\$1,118,145</b>	<b>\$10,409,743</b>

As indicated by the table above, the Company stated that there were no transactions during the examination period between WIC and various affiliates, pursuant to the following intercompany agreements: Underwriting Management Agreement with CORE Managers, Service Agreement with FSIC, Service Agreement with GEISA, Computer Services Agreement with GE, Service Agreement with Coregis, Services Agreement with GE Re, and the Consulting Agreement with iProcess and other affiliates. These Agreements do not appear to be necessary due to the lack of use during the examination period. The Company is directed to investigate the need for each of these Agreements. For any Agreements in which it is determined that there will not be any future transactions involving Westport, such Agreements should be either amended to remove Westport or terminated.

The Company could not provide a reconciliation to identify the amounts paid or received by Westport for each intercompany agreement that would support the payments with affiliates that were reported in Schedule Y – Part 2 of the 2003 Annual Statement. The accuracy of the reported amounts could not be verified without such a reconciliation. The Company is directed to implement accounting procedures to track the specific payments made or received by intercompany agreement for amounts reported in Schedule Y – Part 2.

The Company also received capital contributions totaling \$130,000,000 from ERC during 2002.

### **FIDELITY BOND AND OTHER INSURANCE**

The Company's ultimate parent, GE, self-insures the first \$25,000,000 of fidelity insurance coverage for itself and all of its subsidiaries, including WIC. GE also has a crime insurance policy that provides fidelity coverage for all subsidiaries, including WIC, which has a liability limit of \$125,000,000 and a \$25,000,000 deductible. The suggested minimum level of coverage for WIC, according to NAIC guidelines, is \$2,000,000 based upon admitted assets and premiums. The Company stated that there is no agreement with GE or any internal procedures whatsoever to define WIC's financial responsibility in the event that WIC should incur a fidelity loss. A \$25,000,000 deductible for WIC is excessive, in comparison to the NAIC suggested minimum and the \$250,000 deductible that was in effect during the prior examination. The Company is directed to obtain an agreement whereby GE or ERC will agree to indemnify WIC for any fidelity losses in excess of \$250,000 up to the \$2,000,000 minimum level recommended by the NAIC. As an alternative, WIC could choose to obtain its own insurance policy to cover the first \$2,000,000 of exposure.

GE is also a named insured on several other insurance policies. Although WIC is not specifically named as an insured on most of these policies, the terms define coverage as being applicable to all subsidiaries of GE, which would include WIC. These additional insurance policies are as follows: property, commercial general liability, commercial umbrella liability, workers compensation, employers' liability, employment practices liability, fiduciary liability, directors' and officers' liability, errors and omissions liability, and business auto.

## PENSION, STOCK OWNERSHIP AND INSURANCE PLANS

The Company had 148 employees, as of May 2005, consisting mostly of sales, marketing, underwriting, and claims personnel. Most employees were located in either the home office building in Overland Park, Kansas or the branch office in Chicago, Illinois. The P&C Select segment of the WIC's operations are managed from the Overland Park, Kansas location and the Specialty segment is managed from the Chicago office. Refer to the Insurance Products and Related Practices section of this report for a description of WIC's operating structure.

WIC has also outsourced a number of its functions to other entities, pursuant to intercompany agreements. Various administrative functions of WIC's business operations are conducted by employees of the direct parent, ERC, and the ultimate parent, GE. The management of its investment portfolio is performed by an affiliate, GE Asset Management Incorporated (GEAM). The investment accounting function is outsourced to State Street Bank and Trust Company (State Street), an unaffiliated entity. State Street is responsible for reconciling investment accounts to the G/L balances and preparing all statutory reports for investments such as Schedule D, DA, BA, and E - Part 2 of the Annual Statement. GECIS, an affiliate located in India, performs various services that include accounting, actuarial, claims, data entry, financial analysis, underwriting, and several other services. Refer to the Intercompany Agreements and Intercompany Transactions sections of this report for a review of WIC's affiliated agreements and transactions.

Benefits provided to WIC, ERC, and GE employees include health insurance, dental insurance, vision insurance, disability insurance, long-term care insurance, life insurance, medical and child care flexible spending accounts, and a 401(k) savings plan with matching contributions. All employees are covered by two separate defined benefit pension plans. Those employees vested prior to October 1, 1999 are covered by the ERC Retirement Plan, while those employees vested on or after October 1, 1999 are covered by the General Electric Pension Plan. The benefits vary between the two pension plans. Post-retirement benefits are also provided to retirees.

## STATUTORY DEPOSITS

### Deposits with the State of Missouri

The funds on deposit with the Missouri Department of Insurance, as of December 31, 2003, were sufficient to meet the capital deposit requirements for the State of Missouri in accordance with Section 379.098 RSMo (Securities Deposit). The funds on deposit as of December 31, 2003, were as follows:

<u>Type of Security</u>	<u>Par Value</u>	<u>Fair Value</u>	<u>Statement Value</u>
State and Municipal Bonds	\$2,725,000	\$2,942,122	\$2,942,122



**Deposits with Other States and Territories**

The Company also has funds on deposit with other states and U.S. territories. Those funds on deposit as of December 31, 2003, were as follows:

<u>State or Territory</u>	<u>Type of Security</u>	<u>Par Value</u>	<u>Fair Value</u>	<u>Statement Value</u>
Arizona	U.S. Treasury Note and Municipal Bonds	\$2,985,000	\$3,237,651	\$3,167,719
Arkansas	State and Municipal Bonds	200,000	205,616	205,616
California	State and Municipal Bonds	8,030,000	8,373,287	8,373,287
Delaware	U.S. Treasury Note And Municipal Bond	125,000	127,428	124,997
Georgia	U.S. Treasury Notes	85,000	94,991	86,751
Guam	U.S. Treasury Note	100,000	99,954	99,664
Idaho	State Bond	275,000	274,786	274,786
Louisiana	U.S. Treasury Note	80,000	90,550	84,768
Maine	Municipal Bond	160,000	164,877	160,384
Massachusetts	U.S. Treasury Note	650,000	695,596	634,258
Nevada	U.S. Treasury Note	125,000	139,336	125,728
New Mexico	U.S. Treasury Note and Municipal Bond	465,000	524,445	473,023
North Carolina	State and Municipal Bonds	320,000	344,675	344,675
Oregon	U.S. Treasury Note and Municipal Bond	390,000	403,041	389,898
Puerto Rico	Municipal Bond	575,000	618,605	618,605
South Carolina	U.S. Treasury Note	280,000	299,337	282,314
Virgin Islands	U.S. Treasury Note	525,000	562,081	504,706
Virginia	U.S. Treasury Note	225,000	240,539	226,859
<b>Total</b>		<u>\$15,595,000</u>	<u>\$16,496,795</u>	<u>\$16,178,038</u>

## INSURANCE PRODUCTS AND RELATED PRACTICES

### Territory and Plan of Operation

Westport is licensed as a property and casualty insurer by the Missouri Department of Insurance under Chapter 379 RSMo (Insurance Other than Life). The Company is licensed and writes business in all fifty states, the District of Columbia, and Puerto Rico. The states with the largest percentage of direct written premiums for 2003 were California (8.5%), Pennsylvania (8.3%), and Florida (8.1%).

Westport is primarily a direct insurer with limited assumed business. Direct premiums represented 94.7% and assumed premiums represented only 5.3% of the total direct and assumed premiums for 2003. The major lines of direct business, based upon 2003 written premiums, are as follows:

<u>Line of Business</u>	<u>Percentage of Direct Written Premiums</u>
Other Liability – Claims Made	26.3%
Workers' Compensation	19.0%
Commercial Multiple Peril	14.5%
Fire	10.2%
All Other	<u>30.0%</u>
Total	100.0%

The Company and other affiliated insurance companies, including the direct parent, ERC, are managed as "GE Insurance Solutions." There are three main profit and loss (P&L) centers of GE Insurance Solutions, as follows: (1) Global Life and Health, (2) P&C Reinsurance, and (3) Commercial Insurance. Global Life and Health consists of ERC's subsidiary, ERAC, and other European affiliated insurers. P&C Reinsurance consists of ERC, its European subsidiary reinsurers, and an affiliate, GE Reinsurance Corporation. WIC is included in the Commercial Insurance P&L center along with ERC and its subsidiaries, FSIC and IRI.

The Commercial Insurance P&L center is divided into sub-P&L's as follows: (1) Healthcare, (2) Specialty, (3) Industrial Risk Insurers, and (4) P&C Select. Another sub-P&L, Medical Protective, existed at December 31, 2003, but was eliminated as a result of General Electric's sale of The Medical Protective Company to Berkshire Hathaway in May 2005. All of the Company's business, in which it retains a net risk, is from the Specialty and P&C Select sub-P&L's. The Specialty center includes lawyers' professional liability and insurance agents' professional liability coverages.

The P&C Select center includes two main segments – CyberComp and Program Managers. CyberComp is a workers' compensation product that is designed to serve the small businesses. The CyberComp business model utilizes an Internet based eligibility and quote engine to target those businesses that generate \$50,000 or less in premiums and have less than 50 employees. At year-end 2003, CyberComp was producing business in 27 states through 900 independent agents.

The Program Managers segment focuses on providing commercial insurance coverage for niche customer groups and specialty product programs. The Company writes commercial property and casualty business in multi-line programs, on a countrywide basis, through Program Managers that are third party Managing General Agents (MGAs) and Managing General Underwriters (MGUs). The MGAs have the authority to underwrite and issue policies and handle the claims for the policies. The MGUs have the authority to underwrite and issue policies only. The Program Managers administer the programs and work directly with independent insurance agents. The average general liability limit is \$1 million per occurrence, with deductibles ranging from \$250 to \$1,000 on average. This segment includes the following lines of business: property, BOP, general liability, liquor liability, crime, fidelity, inland marine, auto, garage, workers' compensation, boiler and machinery, ocean marine, and umbrella.

The Industrial Risk Insurers sub-P&L involves the large property risks usually involving multiple locations. The subject properties insured by IRI require specialized engineers, inspectors, and technical personnel to appraise and evaluate the risks. All of the IRI business is underwritten by WIC, but policy obligations are 100% the responsibility of ERC. Further information about IRI is included in the Affiliated Companies section and the Reinsurance section.

The Company's direct policies are produced by an agency force consisting of 2,727 licensed independent agents.

**Policy Forms & Underwriting**  
**Advertising & Sales Materials**  
**Treatment of Policyholders**

The Missouri Department of Insurance has a market conduct staff that performs a review of these issues and generates a separate market conduct report. A comprehensive MDI market conduct examination was conducted for the Company for the period from January 1, 2003 through December 31, 2003. A market conduct examination report was issued by the MDI on May 19, 2004, which listed high error rates in WIC's underwriting and rating practices and claims handling practices. A fine of \$40,758 was imposed by the MDI for these problems. However, none of the problems identified in the MDI's market conduct report had a material impact on the financial condition of WIC. The management of WIC agreed to address the issues identified in the report.

There were also market conduct examinations performed and reports issued by other states during the examination period. The New York Insurance Department issued a market conduct report on October 4, 2002 for a review of the Company's underwriting and rating practices for the period from July 1, 2000 to June 30, 2001. The New York Insurance Department also issued a market conduct report on October 10, 2003 for a review of the Company's underwriting and rating practices for the public automobile line of business for the period from July 1, 2002 to June 30, 2003. The California Department of Insurance issued a market conduct report on July 22, 2003 for a review of the Company's claim handling practices for the period from July 1, 2000 to June 30, 2001. Numerous errors in violation of state codes were noted in the two New York reports and the California report. However, none of the problems had a material impact on the financial condition of WIC and management agreed to address the issues.

## REINSURANCE

### Premium Activity

The Company's premium activity on a direct written, assumed and ceded basis, for the period under examination, is detailed below:

	<u>2001</u>	<u>2002</u>	<u>2003</u>
Direct Business	\$912,700,168	\$952,615,478	\$946,756,129
Reinsurance Assumed:			
Affiliates	13,462,302	5,869,655	44,080,649
Non-affiliates	28,061,676	24,236,037	8,382,016
Reinsurance Ceded:			
Affiliates	(407,941,535)	(546,131,624)	(619,000,759)
Non-affiliates	<u>(92,195,842)</u>	<u>(101,119,847)</u>	<u>(54,458,756)</u>
<b>Net Written Premiums</b>	<b><u>\$454,086,769</u></b>	<b><u>\$335,469,699</u></b>	<b><u>\$325,759,279</u></b>

### Assumed

The Company has limited amounts of assumed business. Assumed premiums in 2003 from Coregis Insurance Company, an affiliate, were \$44,081,000, which represented 84% of total assumed premiums. Assumed reserves for case losses and loss adjustment expenses from Coregis were \$34,729,000, as of December 31, 2003, which was 41% of the total assumed reserves. The only other significant assumed business in 2003 was \$8,224,000 of assumed premiums from the National Workers Compensation Reinsurance Pool.

The Company has a quota share agreement, effective July 1, 1997, with Coregis to assume 100% of the losses and liability from various policies written by Coregis. Policies to be assumed by Westport are from the following lines of business: commercial property, boiler and machinery, commercial multiple peril, inland marine, earthquake, general liability, automobile liability, umbrella, workers' compensation, directors and officers liability, professional liability for accountants, lawyers, insurance agents, architects and engineers. The Company receives 100% of the premiums for the ceded policies, less a 23% ceding commission retained by Coregis.

Westport has a quota share agreement, effective June 1, 2002, with Coregis to assume 100% of the liability for worker's compensation and employers liability policies written by Coregis. The Company receives 100% of the premiums for the ceded policies, less a 5% ceding commission retained by Coregis.

### **Ceded**

The Company is contingently liable for all reinsurance losses ceded to others. This contingent liability would become an actual liability in the event that an assuming reinsurer fails to perform its obligations under the reinsurance agreement.

The business reported as ceded to the Company's parent, ERC, and Industrial Risk Insurers (IRI), an affiliate, accounted for most of the total 2003 ceded premiums and the total ceded reserves, as of December 31, 2003. Below are the amounts reported by WIC:

Reinsurer	2003 Ceded Premiums	12/31/2003 Ceded Loss and LAE Reserves
Employers Reinsurance Corporation	\$418,653,000	\$494,920,000
Industrial Risk Insurers	<u>199,358,000</u>	<u>785,893,000</u>
Subtotal	\$618,011,000	\$1,280,813,000
 Total for All Ceded Business	 \$673,460,000	 \$1,488,043,000
 Percentage of Total	 91.77%	 86.07%

The Company has a three separate Quota Share Reinsurance Agreements, all effective December 31, 2001, with ERC. Under the nearly identical terms of all three agreements, WIC cedes 100% of the premiums and losses for the following three lines of business: worker's compensation policies referred to as the "CyberComp" business program, lawyers' errors and omissions policies, and insurance agents and brokers professional liability policies. WIC receives a ceding commission, which ranges from 20% to 29%, under the terms of the Agreements.

WIC and Coregis Insurance Company have a Casualty Excess of Loss Retrocession Agreement, effective January 1, 2002, with ERC. For any direct written or assumed casualty policies, WIC will cede losses in excess of \$2,000,000 per occurrence, up to a maximum limit of \$8,000,000 per occurrence. WIC and Coregis will pay ERC premiums equal to 6% of the net premiums from casualty business, less a 25% ceding commission.

Westport has a Whole Account Aggregate XOL Retrocession Contract with ERC, which was effective for the 2003 accident year. Per the terms of the Contract, ERC assumes any net losses in excess of a 61% loss ratio subject to a maximum liability of \$60,000,000. The premium to be paid by Westport will equal 52% of any losses ceded to ERC with a minimum premium of \$1,200,000.

The business reported by the Company as ceded to IRI functionally operates as direct business of WIC's parent, ERC. IRI is a voluntary association that has only two members. ERC has a 99.5% membership interest and Westport has the remaining 0.5% membership interest. All of the policies issued by IRI are underwritten by WIC. However, WIC has an agreement with ERC that transfers the rights and obligations from WIC's 0.5% membership interest to ERC. Thus, all 100% of the business produced by IRI is the responsibility of ERC. WIC is essentially fronting the IRI business for ERC. There are no reinsurance agreements between ERC, IRI, or WIC, even though the Company reports premiums and loss reserves ceded to IRI in its Annual Statement.

## **ACCOUNTS AND RECORDS**

The CPA firm, KPMG, LLP, of Kansas City, Missouri, issued audited statutory financial statements of the Company for all years in the examination period.

The actuarial opinion regarding the Company's reserves for losses and loss adjustment expenses was issued by Roger A. Atkinson III, FCAS, MAAA for all years in the examination period. Mr. Atkinson is employed by the Company as the Chief Actuary, a position that is elected annually by the Board of Directors.

The Company closes its books and records for year-end transactions prior to December 31 of each year. WIC's ultimate parent, GE, requires its subsidiaries to provide early financial statement information to facilitate timely reporting of GE's consolidated financial statements. Thus, most of the assets and liabilities reported in the 2003 Annual Statement are not the balances as of December 31, 2003. For example, invested asset balances represent holdings as of December 17, 2003. Direct premiums, case loss reserves, and cash accounts represent balances as of December 18, 2003. Other timing problems occur from the information reported from ceding companies on reinsurance assumed business. The Company is directed to disclose its accounting practice for reporting asset and liability balances with dates prior to December 31 in the Notes to the Financial Statement section of the Annual Statement. Such disclosure is required by SSAP No. 1, paragraph 5. Each year, the various cut-off dates that are used should be disclosed and the applicable asset and liabilities that are affected by each cut-off date.

## FINANCIAL STATEMENTS

The following financial statements, with supporting exhibits, present the financial condition of Westport Insurance Corporation for the period ending December 31, 2003. Any examination adjustments to the amounts reported in the financial statements and/or comments regarding such are made in the “Notes to the Financial Statements.” The failure of any column of numbers to add to its respective total is due to rounding or truncation.

There may have been additional differences found in the course of this examination, which are not shown in the “Notes to the Financial Statements.” These differences were determined to be immaterial concerning their effect on the financial statements, and therefore, were only communicated to the Company and noted in the workpapers for each individual Annual Statement item.

## Assets as of December 31, 2003

	<u>Assets</u>	Non-Admitted <u>Assets</u>	Net Admitted <u>Assets</u>
Bonds	\$866,701,692	\$0	\$866,701,692
Preferred Stocks	3,324,375	0	3,324,375
Cash and Short-Term Investments	90,477,156	0	90,477,156
Receivable for Securities	23,450,771	0	23,450,771
Investment Income Due and Accrued	10,948,429	0	10,948,429
Uncollected Premiums and Agents' Balances in the Course of Collection (Note 1)	116,965,435	26,528,533	90,436,902
Deferred Premiums, Agents' Balances Booked But Deferred and Not Yet Due	78,339,928	7,140,654	71,199,274
Amounts Recoverable from Reinsurers	67,936,439	0	67,936,439
Funds Held by or Deposited with Reinsured Companies	769,342	0	769,342
Federal Income Tax Recoverable	14,010,304	0	14,010,304
Net Deferred Tax Asset	45,773,921	19,043,448	26,730,473
Guaranty Funds Receivable or On Deposit	38,941	0	38,941
Receivables from Parent, Sub., and Affiliates	3,437,364	0	3,437,364
Aggregate Write-Ins: Other Assets	<u>8,852,229</u>	<u>4,236,525</u>	<u>4,615,704</u>
<b>TOTAL ASSETS</b>	<b><u>\$1,331,026,326</u></b>	<b><u>\$56,949,160</u></b>	<b><u>\$1,274,077,166</u></b>



## Liabilities, Surplus and Other Funds as of December 31, 2003

Losses (Note 2)	\$ 556,312,124
Reinsurance Payable on Paid Loss and LAE	8,822,397
Loss Adjustment Expenses (Note 2)	89,396,116
Commissions Payable	5,855,687
Other Expenses	3,341,233
Taxes, Licenses and Fees	10,271,943
Unearned Premiums	145,087,984
Policyholder Dividends Declared and Unpaid	4,551
Ceded Reinsurance Premiums Payable	127,695,843
Funds Held by Company Under Reinsurance Treaties	390,891
Amounts Withheld or Retained	0
Remittances and Items Not Allocated (Note 1)	32,891,106
Provision for Reinsurance	40,614,295
Payable for Securities	<u>31,365,712</u>
<b>TOTAL LIABILITIES</b>	<b>\$1,052,049,882</b>
Common Capital Stock	5,000,000
Gross Paid In and Contributed Surplus	367,583,825
Unassigned Funds (Surplus)	<u>(150,556,541)</u>
Capital and Surplus	<b><u>\$ 222,027,284</u></b>
<b>TOTAL LIABILITIES AND SURPLUS</b>	<b><u>\$1,274,077,166</u></b>

## Statement of Income

### For the Year Ended December 31, 2003

<b>Premium Earned</b>	<b>\$326,280,109</b>
DEDUCTIONS:	
Losses Incurred	218,235,820
Loss Expenses Incurred	86,051,876
Other Underwriting Expenses Incurred	<u>93,876,602</u>
<b>Total Underwriting Deductions</b>	<b><u>\$398,164,298</u></b>
<b>Net Underwriting Loss</b>	<b>(\$71,884,189)</b>
 Net Investment Income Earned	 36,726,184
Net Realized Capital Gains	<u>12,575,097</u>
<b>Net Investment Gain</b>	<b>\$49,301,281</b>
 Other Income	 18,241
Dividends to Policyholders	168,272
Federal Income Taxes Incurred	<u>(35,777,584)</u>
 <b>Net Income</b>	 <b><u>\$13,044,645</u></b>
 <b>CAPITAL AND SURPLUS ACCOUNT:</b>	
Surplus as Regards Policyholders, December 31, 2002	\$280,458,219
Net Income	13,044,645
Change in Net Unrealized Capital Gains or (Losses)	(295,371)
Change in Net Deferred Income Tax	(18,120,310)
Change in Nonadmitted Assets	24,814,988
Change in Provision for Reinsurance	4,125,113
Examination Changes	<u>(82,000,000)</u>
<b>Surplus as Regards Policyholders, December 31, 2003</b>	<b><u>\$222,027,284</u></b>

## Notes to the Financial Statements

<b>Note 1 – Uncollected Premiums and Agents Balances</b>	<b>\$24,654,690</b>
<b>Remittances and Items Not Allocated</b>	<b>\$32,891,106</b>

Suspense accounts for unapplied or mismatched cash receipts were incorrectly imbedded in the Uncollected Premiums line. Account No. 108080, titled "WIC Batch Suspense", with a liability balance of \$25,816,031, represented batch totals of cash receipts received the last four days prior to the year-end cutoff date that had not been applied to specific policies. Account No. 10810W, titled "Agents Bal-MGA", included suspense balances that totaled \$7,075,075 for items such as amounts paid in excess of balances due and payments received with a policy application. SSAP No. 67, paragraph 9, classifies these types of suspense amounts as Remittances and Items Not Allocated. An examination change was made to reclassify the \$32,891,106 of suspense balances from the Uncollected Premiums line to the Remittances and Items Not Allocated line. The Company is directed to properly report suspense accounts and suspense items, as defined in SSAP No. 67, paragraph 9, in the Remittances and Items Not Allocated line of the Annual Statement. Reclassify items from Uncollected Premiums to the Remittances line.

<b>Note 2 – Losses</b>	<b>\$556,312,124</b>
<b>Loss Adjustment Expenses</b>	<b>\$ 89,396,116</b>

The MDI engaged Expert Actuarial Services, LLC (EAS) to perform an actuarial review of the loss and loss adjustment expense reserves of WIC. EAS issued an actuarial opinion and report to the MDI and determined that WIC's reported loss and LAE reserves of \$563,708,240, as of December 31, 2003, were deficient by \$82,000,000. An examination change was made to increase loss reserves by the indicated deficiency. This amount consists of two components. First, the development of the December 31, 2003 reserves through September 30, 2004 showed a deficiency of \$100,000,000, as reported in WIC's 2004 Quarterly Statements. Second, EAS determined that the asbestos and environmental reserves for WIC were redundant by \$18,000,000.

Schedule P of WIC's 2004 Annual Statement reported adverse development of incurred losses and loss adjustment expenses of \$125,955,000 from December 31, 2003 to December 31, 2004. Per information provided by WIC, the Company recorded \$113,000,000 of reserve strengthening adjustments in 2004 to account for the majority of the development. WIC's reserve strengthening adjustments and the overall one-year adverse development in 2004 supports the reasonableness of the \$82,000,000 reserve deficiency that was determined by EAS.

As a result of the large deficiency in WIC's loss reserves, as determined by EAS, the MDI engaged EAS to perform an additional reserve analysis, as of December 31, 2004. Refer to the Subsequent Events section of this report for further details on this updated analysis.

## Examination Changes

### Capital and Surplus Per Company, December 31, 2003:

Common Capital Stock	\$ 5,000,000
Gross Paid In and Contributed Surplus	367,583,825
Unassigned Funds (Surplus)	<u>(68,556,541)</u>
<b>Total Capital and Surplus Per Company</b>	<b>\$304,027,284</b>

### Examination Changes:

Reclassify Suspense Accounts** (Note 1)	\$ 0
Increase Loss Reserves for Deficiency (Note 2)	<u>(82,000,000)</u>
<b>Total Examination Changes</b>	<b>(\$82,000,000)</b>

### Capital and Surplus Per Examination, December 31, 2003:

Common Capital Stock	\$ 5,000,000
Gross Paid-in and Contributed Surplus	367,583,825
Unassigned Funds (Surplus)	<u>(150,556,541)</u>
<b>Total Capital and Surplus Per Examination</b>	<b><u>\$222,027,284</u></b>

\*\* No net surplus impact from this reclassification

## **General Comments and/or Recommendations**

### **GE Service Mark Agreement (page 15)**

The Service Mark Agreement with GE Insurance Solutions, effective January 1, 2000, was never filed for prior approval with the MDI, as required by Section 382.195 RSMo. (Transactions Within a Holding Company System). The Company is directed to immediately submit this Agreement as part of a Form D filing to the MDI for approval. Payments made by ERC under this Agreement should cease until the Agreement is approved by the MDI.

### **Agreements Not Signed (page 18)**

The Company could not provide signed agreements for the Consulting Agreement with iProcess and other affiliates, and the Services Agreement with ERC and GE Re. Therefore, these agreements were apparently never formally executed since they were never signed by the parties. The Company is directed to immediately execute these agreements and cease all transactions until the agreements are executed.

### **Intercompany Agreements with No Transactions (page 19)**

The Company stated that there were no transactions during the examination period between WIC and various affiliates, pursuant to the following intercompany agreements: Underwriting Management Agreement with CORE Managers, Service Agreement with FSIC, Service Agreement with GEISA, Computer Services Agreement with GE, Service Agreement with Coregis, Services Agreement with GE Re, and the Consulting Agreement with iProcess and other affiliates. These Agreements do not appear to be necessary due to the lack of use during the examination period. The Company is directed to investigate the need for each of these Agreements. For any Agreements in which it is determined that there will not be any future transactions involving Westport, such Agreements should be either amended to remove Westport or terminated.

### **Intercompany Payments Reported on Schedule Y (page 20)**

The Company could not provide a reconciliation to identify the amounts paid or received by Westport for each intercompany agreement that would support the payments with affiliates that were reported in Schedule Y – Part 2 of the 2003 Annual Statement. The accuracy of the reported amounts could not be verified without such a reconciliation. The Company is directed to implement accounting procedures to track the specific payments made or received by intercompany agreement for amounts reported in Schedule Y – Part 2.

**Fidelity Bond Insurance (page 20)**

The Company's ultimate parent, GE, self-insures the first \$25,000,000 of fidelity insurance coverage for itself and all of its subsidiaries, including WIC. The suggested minimum level of coverage for WIC, according to NAIC guidelines, is \$2,000,000 based upon admitted assets and premiums. The Company stated that there is no agreement with GE or any internal procedures whatsoever to define WIC's financial responsibility in the event that WIC should incur a fidelity loss. A \$25,000,000 deductible for WIC is excessive, in comparison to the NAIC suggested minimum and the \$250,000 deductible that was in effect during the prior examination. The Company is directed to obtain an agreement whereby GE will agree to indemnify WIC for any fidelity losses in excess of \$250,000 up to the \$2,000,000 minimum level recommended by the NAIC. As an alternative, WIC could choose to obtain its own insurance policy to cover the first \$2,000,000 of exposure.

**Year-End Reporting Dates (page 27)**

The Company closes its books and records for year-end transactions prior to December 31 of each year. The Company is directed to disclose its accounting practice for reporting asset and liability balances with dates prior to December 31 in the Notes to the Financial Statement section of the Annual Statement. Such disclosure is required by SSAP No. 1, paragraph 5. Each year, the various cut-off dates that are used should be disclosed and the applicable asset and liabilities that are affected by each cut-off date.

**Reporting of Suspense Items (pages 32)**

Suspense accounts totaling \$32,891,106, as of December 31, 2003, for unapplied or mismatched cash receipts were incorrectly imbedded in the Uncollected Premiums line. SSAP No. 67, paragraph 9, classifies these types of suspense amounts as Remittances and Items Not Allocated. An examination change was made to reclassify the \$32,891,106 of suspense balances from the Uncollected Premiums line to the Remittances and Items Not Allocated line. The Company is directed to properly report suspense accounts and suspense items, as defined in SSAP No. 67, paragraph 9, in the Remittances and Items Not Allocated line of the Annual Statement.

**Loss Reserving Practices (pages 32 and 37)**

The MDI engaged Expert Actuarial Services, LLC (EAS) to perform an actuarial review of the loss and loss adjustment expense reserves of WIC. EAS issued an actuarial opinion and report to the MDI and determined that WIC's reported loss and LAE reserves of \$563,708,240, as of December 31, 2003, were deficient by \$82,000,000. WIC's reported reserves, as of December 31, 2003, were inadequate due to this large deficiency. The deficiency was due to adverse development of the loss and LAE reserves in 2004.

EAS also reviewed the Company's reported loss and LAE reserves of \$572,041,000, as of December 31, 2004, and issued an actuarial opinion and report to the MDI and determined that the reserves were reasonable.

However, the loss and LAE reserves recorded by WIC have been deficient every year from 1999 through 2003, when compared to the actual development that occurred. These deficiencies correspond with the findings of MDI's consulting actuary, EAS, regarding the December 31, 2003 loss and LAE reserves. Management and the Board of Directors are directed to address the long history of reserve deficiencies that WIC has reported. Reasons for the continually deficient reserves should be identified and corrective actions should be taken to reduce the likelihood of future reserve deficiencies. Management is further directed to ensure that the loss and LAE reserves are estimated conservatively in adherence to the concept of conservatism that is explained in paragraphs 29 and 30 of the Preamble to the Accounting Practices and Procedures Manual of the NAIC.

## SUBSEQUENT EVENTS

### Actuarial Review of December 31, 2004 Reserves

MDI's consulting actuary, EAS, reviewed the Company's loss and LAE reserves of \$572,040,093 that were reported, as of December 31, 2004. EAS issued a report and opinion that found the reserves to be reasonable. However, the loss and LAE reserves recorded by WIC have been continually deficient for every year in recent history. The table below shows the development of WIC's loss and LAE reserves during the five-year period from 1999 through 2003, as reported in WIC's Annual Statements.

<u>Year</u>	<u>Loss and LAE Reserves, as of December 31</u>	<u>One-Year Deficiency</u>	<u>Percent Def.</u>	<u>Two-Year Deficiency</u>	<u>Percent Def.</u>
1999	\$440,710,000	\$ 21,235,000	4.8%	\$ 32,529,000	7.4%
2000	512,651,000	4,745,000	0.9%	93,856,000	18.3%
2001	623,085,000	118,739,000	19.1%	203,815,000	32.7%
2002	622,418,000	92,642,000	14.9%	209,713,000	33.7%
2003	563,708,000	125,955,000	22.3%	-na-	-na-

The table below shows the development of WIC's loss and LAE reserves, as of December 31, 2004, in comparison to the reserves originally recorded for each accident year from 1997 through 2003, as reported in WIC's Annual Statements.

<u>Accident Year</u>	<u>Loss and LAE Reserves Recorded as of December 31 of Accident Year</u>	<u>Developed Loss and LAE Reserves Recorded as of December 31, 2004</u>	<u>Cumulative Deficiency</u>	<u>Percent Deficiency</u>
1997	\$35,166,000	\$50,672,000	\$15,506,000	44.1%
1998	153,498,000	199,816,000	46,318,000	30.2%
1999	204,022,000	216,951,000	12,929,000	6.3%
2000	225,473,000	309,441,000	83,968,000	37.2%
2001	342,966,000	392,923,000	49,957,000	14.6%
2002	221,148,000	256,778,000	35,630,000	16.1%
2003	180,009,000	188,893,000	8,884,000	4.9%
	<u>\$1,362,282,000</u>	<u>\$1,615,474,000</u>	<u>\$253,192,000</u>	<u>18.6%</u>

Management and the Board of Directors are directed to address the long history of reserve deficiencies that WIC has reported. Reasons for the continually deficient reserves should be identified and corrective actions should be taken to reduce the likelihood of future reserve deficiencies. Management is further directed to ensure that the loss and LAE reserves are estimated conservatively in adherence to the concept of conservatism that is explained in



paragraphs 29 and 30 of the Preamble to the Accounting Practices and Procedures Manual of the NAIC.

### **Hurricane Activity**

A series of large hurricanes occurred in 2004 and 2005 that caused material losses for WIC. Estimated losses from Hurricanes Charley, Frances, Ivan, and Jeanne in 2004 totaled \$82,000,000 on a gross basis and \$29,000,000 net of reinsurance. Estimated losses from Hurricane Katrina in 2005 are \$44,000,000 on a gross basis and \$7,000,000 net of reinsurance. Loss estimates were the latest information provided as of the date of this report.

### **Acquisition by Swiss Re**

On November 18, 2005, it was announced that GE had agreed to sell Westport's parent holding company, GE Insurance Solutions, to Swiss Reinsurance Company (Swiss Re) for \$6.8 billion. No transactions have been proposed in conjunction with the acquisition, which would significantly affect the organizational structure or business operations of Westport. The Company will strengthen its reserves for loss and loss adjustment expenses by approximately \$181,000,000, due to deficiencies identified by the Company and Swiss Re, as a condition of the purchase agreement. The sale is expected to close in mid-2006 after regulatory approvals have been received.

## ACKNOWLEDGMENT

The assistance and cooperation extended by the officers and the employees of Westport Insurance Corporation during the course of this examination is hereby acknowledged and appreciated. In addition to the undersigned, Leslie Nehring, Angela Campbell, CFE, Bernie Troop, CFE, Al Garon, CFE, Karen Baldree, CFE, and Andy Balas, CFE, examiners for the Missouri Department of Insurance, participated in this examination. The firm of Expert Actuarial Services, LLC, also participated as a consulting actuary.

## VERIFICATION

State of Missouri )  
 )  
County of Boone )

I, Tim L. Tunks, on my oath swear that to the best of my knowledge and belief the above examination report is true and accurate and is comprised of only facts appearing upon the books, records or other documents of Westport Insurance Corporation, its agents or other persons examined or as ascertained from the testimony of its officers or agents or other persons examined concerning its affairs and such conclusions and recommendations as the examiners find reasonably warranted from the facts.

Tim L. Tunks  
Tim L. Tunks, CPA, CFE  
Examiner-In-Charge  
Missouri Department of Insurance

Sworn to and subscribed before me this 16<sup>th</sup> day of February, 2006.

My commission expires: May 1, 2008 Deanne J. Nolke  
Notary Public

DEBBIE J. NOLKE  
Notary Public - Notary Seal  
STATE OF MISSOURI  
County of Boone  
My Commission Expires May 1, 2008

William W. Viner, Jr.

William W. Viner, Jr., CFE  
Examiner  
Nevada Division of Insurance  
Western Zone, NAIC

### SUPERVISION

The examination process has been monitored and supervised by the undersigned. The examination report and supporting workpapers have been reviewed and approved. Compliance with NAIC procedures and guidelines as contained in the Financial Condition Examiners Handbook has been confirmed.

Frederick G. Heese

Frederick G. Heese, CFE, CPA  
Audit Manager  
Missouri Department of Insurance



## GE Insurance Solutions

Employers Reinsurance Corporation  
9201 State Line Road  
Kansas City, MO 64114  
USA

April 28, 2006

VIA EXPRESS MAIL SERVICE

Mr. Kirk Schmidt  
Chief Financial Examiner  
Division of Financial Regulation  
Missouri Department of Insurance  
301 West High, Room 630  
Jefferson City, MO 65101

RECEIVED

MAY 5 2006

DIVISION  
FINANCIAL REGULATION

Re: Draft Report of Association Financial Examination (as of December 31, 2003)  
Westport Insurance Corporation

Dear Mr. Schmidt,

Westport Insurance Corporation (WIC) is in receipt of the draft of the above-captioned report dated February 8, 2006 and provided to us for review on April 10, 2006. WIC appreciates the opportunity to review the report and provide comments. Accordingly, WIC respectfully requests that this letter be incorporated into or attached to the final financial examination report of the Missouri Department of Insurance (MDI).

In providing comments, WIC discusses each item in the order in which it was presented in the General Comments and/or Recommendations section of the draft examination report:

**GE Service Mark Agreement:** The draft report stated that the Service Mark Agreement between WIC and GE Insurance Solutions Corporation, effective January 1, 2000, was not filed for prior approval through a Form D filing. The report includes a draft directive for WIC to do so. On March 24, 2006, WIC submitted a Form D to MDI concerning this agreement; on April 24, 2006, MDI issued a letter of non-disapproval with respect to this transaction.

**Agreements Not Signed:** The draft report stated that WIC could not provide signed copies of two intercompany agreements during the course of the examination. The report includes a draft directive for WIC to execute these agreements. WIC notes that the Consulting Agreement with iProcess International, LLC has been terminated and that the Services Agreement with Employers Reinsurance Corporation and GE Reinsurance Corporation has been executed.

**Intercompany Transactions with No Transactions:** The draft report stated there were several intercompany agreements pursuant to which there appeared to be no transactions during the examination period. The report includes a draft directive for WIC to investigate the need for each of the agreements, and amend or terminate the agreements as necessary. WIC notes that the pending sales transaction between General Electric Company (GE) and Swiss Reinsurance Company (Swiss Re), through which WIC is being sold to Swiss Re, may lead to an alteration of WIC's affiliate contract

arrangements. In relation to that transaction, WIC is currently undertaking an examination of its intercompany agreements. WIC will make the necessary changes to existing intercompany agreements, but notes that there may be reasons for keeping agreements in place even where there has not been recent transaction activity.

**Intercompany Payments Reported on Schedule Y:** The draft report stated that WIC could not provide reconciliation to identify amounts paid or received for each intercompany agreement that would support payments reported on Schedule Y, Part 2 of the 2003 Annual Statement. The report included a draft directive to implement procedures to track specific payments made or received by intercompany agreements for amounts reported in Schedule Y, Part 2. In 2005, WIC implemented new procedures to ensure the accurate completion of Schedule Y, Part 2. These procedures address intercompany transactions relating to cost sharing agreements with affiliates.

**Fidelity Bond Insurance:** The draft report discusses GE's fidelity insurance coverage for itself and its subsidiaries, and states that the \$25,000,000 deductible potentially applicable to WIC is excessive. The report includes a draft directive for WIC to obtain an agreement whereby GE or ERC will indemnify WIC for any fidelity losses in excess of \$250,000 up to the \$2,000,000 level recommended by NAIC guidelines or obtain its own insurance policy to cover the first \$2,000,000 of exposure. Within the context of the pending GE-Swiss Re transaction, WIC will undertake a thorough evaluation of its insurance coverage, and expects to implement any changes that may remain necessary to comply with NAIC guidelines.

**Year-End Reporting Dates:** The draft report stated that timing problems occur because of WIC's practice of closing its books and records prior to December 31. The report includes a draft directive for WIC to disclose its accounting practice for reporting asset and liability balances with dates prior to December 31 in the Notes to the Financial Statement section of the Annual Statement. Beginning with the 2005 Annual Statement, WIC disclosed in the Notes to the Financial Statements its accounting practice of reporting asset and liability balances with dates prior to December 31.

**Reporting of Suspense Items:** The draft report states that suspense accounts for unapplied or mismatched cash receipts were incorrectly imbedded in Uncollected Premiums line of the Annual Statement. The report also included an examination change of \$32,891,106 to reclassify this amount to the Remittances and Items Not Allocated line. The report further included a draft directive to properly report suspense accounts and suspense items in Remittances and Items Not Allocated line of Annual Statement. Beginning with the 2005 Annual Statement, WIC reported unapplied or mismatched cash receipts included in Uncollected Premium as Remittances and Items Not Allocated in accordance with Statement of Statutory Accounting Procedure No. 67, paragraph 9.


**Loss Reserving Practices:** The draft report discussed MDI's engagement of Expert Actuarial Services, LLC (EAS) to perform an actuarial review of WIC's loss and loss adjustment expense (LAE) reserves. EAS reported a loss and LAE reserve deficiency as of December 31, 2003 of \$82,000,000, the amount by which the report makes corresponding examination changes. WIC wishes to note that the \$82,000,000 of implied deficiency is not based on internal analysis by EAS but reflects the impact of reserving actions actually taken by WIC in 2004. The report includes a draft directive for the management and the Board of Directors of WIC to address recent reserve deficiencies to reduce likelihood of future reserve deficiencies, and to ensure reserves are conservatively estimated. In 2005, WIC updated all significant actuarial assumption categories, which included a thorough review of those areas for which unintentional bias may have been present in prior assumptions. WIC's reserve strengthening in 2005 amounted to \$130 million as a result of this analysis, and WIC's overall reserve position is more conservative generally. WIC believes its actions will reduce significantly the likelihood

Page 3  
April 28, 2006  
Mr. Kirk Schmidt

of future adverse development. Further, WIC regularly conducts rigorous reviews of its reserve position, and WIC management and the Board of Directors remain committed to ensuring WIC possesses adequate reserves in relation to its liabilities.

WIC appreciates the opportunity to provide these comments for consideration by MDI and inclusion in the final examination report. While WIC reserves the right to re-visit its proposed course of action following the close of the GE-Swiss Re transaction, we look forward to working with MDI in resolving any issues for which corrective action is required. If you have any comments or questions regarding these comments, please let us know.

Sincerely,

  
Mark Elborne  
General Counsel

